

Effect of Activist Investing on Stock Returns in the Restaurant Industry

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INTRODUCTION:

Activist investing has been a hot button topic in the business world for years. As activist investors continue to affect the global marketplace and business structure in the United States, their overall effect on companies is still largely in question. Activist investors take ownership in a company that they “target”, which is usually one that has been struggling, is sitting on cash, or needs to be restructured. Historically, these investors encourage and, if they have a large enough ownership, demand that companies raise their dividends, cut costs, and increase stock buybacks. Their main purpose is to create value for investors. However, what are the ultimate costs of these decisions?

Advocates for Activists:

- Makes for efficient markets
- Improves firm efficiency
- Trims unnecessary fat from organizational structure
- Equity is returned to economy through other purchases

Against Activists:

- Short-term focused
- Not helping to promote long-term success
- Money spent on satisfying shareholders rather than investing in innovation and development
- Leads to lower job creation
- Lost economic demand
- Lower firm value

AIM:

My research will be focusing on the effects of these investors on stock returns within the fast food and fast casual restaurant industry.

This research will help:

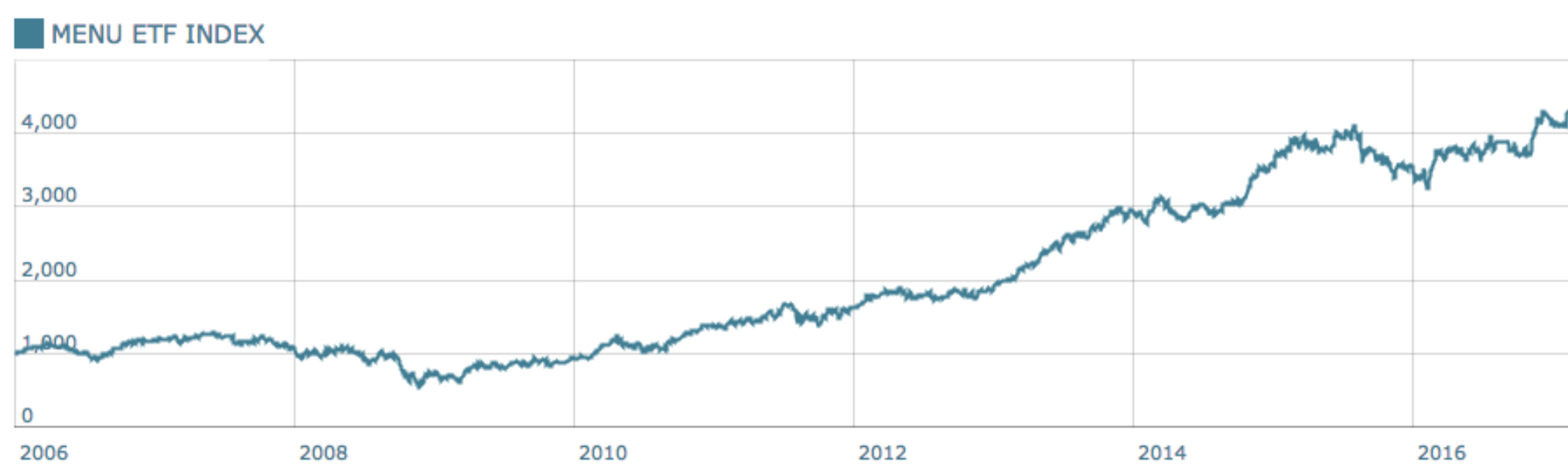
- Publicly-traded companies make investment decisions and weigh the pros and cons of allowing activist investors into their boardrooms
- Allow the markets to better estimate the value that will be derived within the restaurant industry, or other industry with similar characteristics, when an activist investor gets involved in a firm
- Show companies the effects of shorter term activist involvement versus the long-term effects.

METHODOLOGY

Research

- Compiled a collection of 10 firms in the fast-food and fast-casual restaurant industry that had been involved with an activist investor
 - Collected stock prices of these companies at different points along the firms timeline, including:
 - One year before announcement of activist involvement
 - 10 days before announcement of activist involvement
 - The day of announcement of activist involvement
 - 10 days after announcement of activist involvement
 - 1 year after the announcement of activist involvement
 - The stock price on 11/29/2016 (cut off for study)
- (Data on dates was collected from accredited news outlets)
- Looked at how these returns compared to the overall industry as a whole by comparing it to MenuETF Index (a restaurant industry tracking ETF)
 - If the stock had performed poorly (didn’t beat the returns of the MenuETF Index or the S&P 500) then it is clear that the activist investors strategy was not effective
 - If the stock beat the index and the S&P 500, then the investment was considered a success

Menu ETF Index Performance (2006-Present)

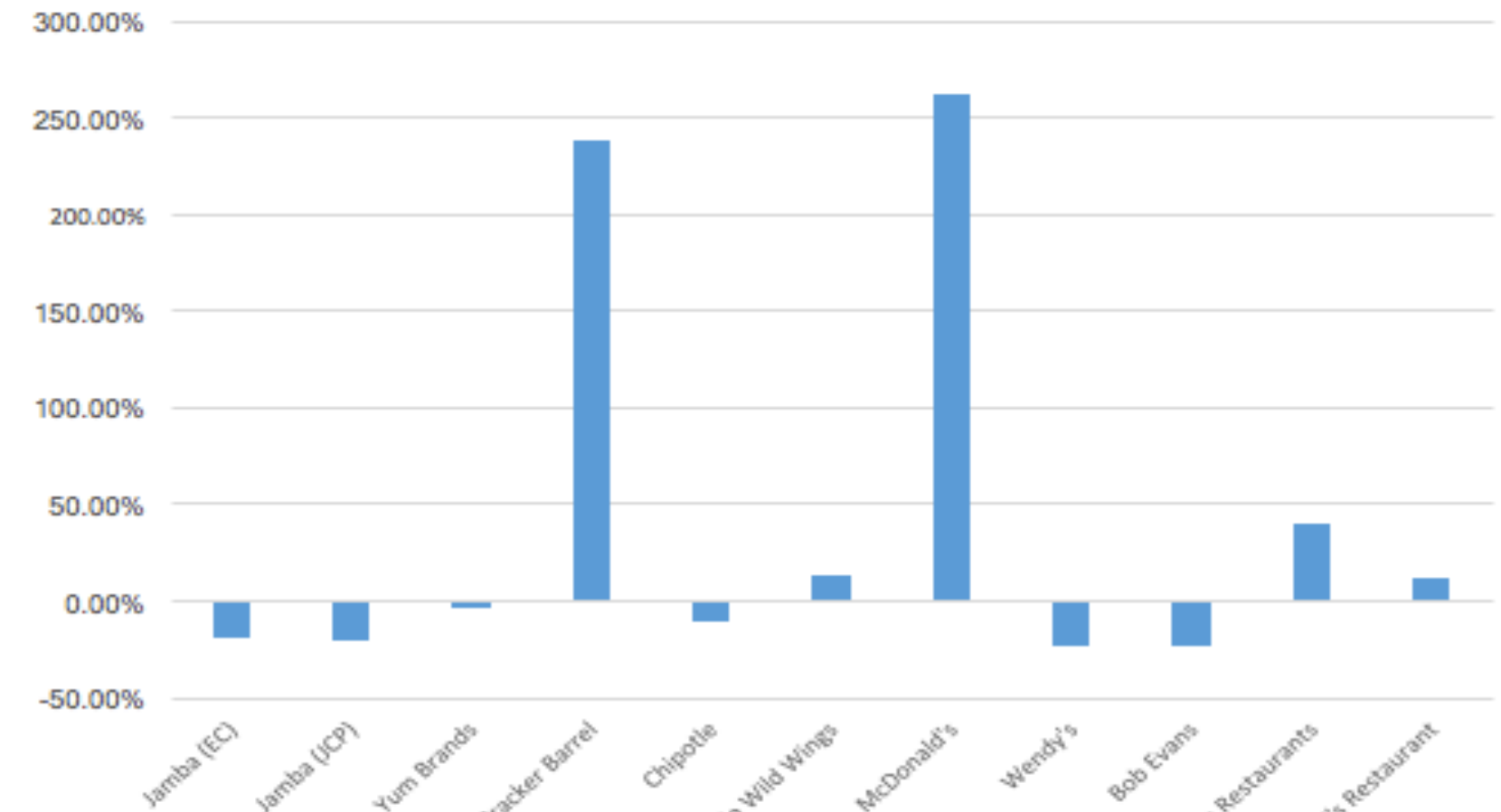


- Compiled a group of 5 firms in the fast-food and fast-casual industry that had not had any activist involvement
- Averaged the returns of these 5 firms over the same time periods that the firms with activist involvement had been measured over
- Ran a paired T-Test by comparing the returns of the firms without activist investors with the returns of the firms that had activist involvement

INITIAL FINDINGS

- Range of activist position size varies greatly (2.3%-69%)
- 4 years on average of activist involvement
- 12 activist hedge funds involved

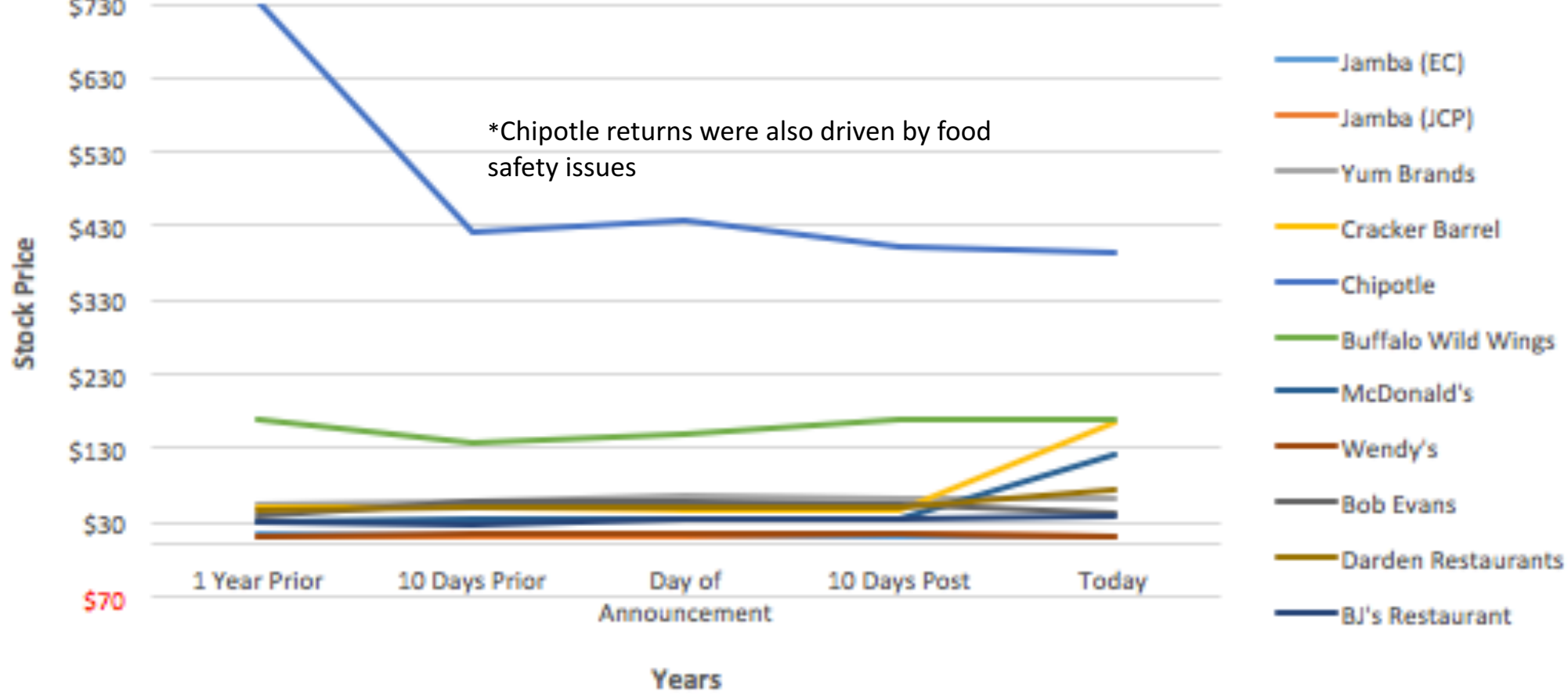
Returns Since Announcement of Activist Involvement to Present



KEY RESULTS & FINDINGS

- 50% had positive returns since the announcement of activist involvement
- 40% beat the market returns of the ETF
- 80% of the companies saw a positive stock jump after the announcement of activist involvement
- The average stock price increase upon the announcement of activist involvement was \$3.78
- 70% of the companies’ stock prices were up one year after the announcement of activist involvement
- Average amount that a stock was up between one year before the announcement and one year after the announcement of activist involvement was \$8.79

Stock Performance of Firms 1 Year Prior to Announcement to Present



- From the paired T-Test we found that there was a difference in the returns for firms with activist investors and firms without from both:
 - The 10 days before activist announcement to 10 days post activist announcement timeframe
 - And the 1 year prior to activist announcement to 1 year after the announcement timeframe
- Firms with activist involvement saw higher returns than firms without activist involvement over the time frame from 10 days before activist announcement to 10 days after activist announcement
- Firms without activist involvement saw higher returns than firms with activist investors over the 1 year pre-announcement to 1 year post-announcement timeline

T- Test Results (10 Day Prior to 10 Day Post)

t-Test: Paired Two Sample for Means		
	W/ Activist	W/O Activist
Mean	2.101818182	-2.018181818
Variance	172.3310564	103.4803964
Observations	11	11
Pearson Correlation	0.673862149	
Hypothesized Mean Difference	0	
df	10	
t Stat	1.395815141	
P(T<=t) two-tail	0.192985549	
t Critical two-tail	2.228138852	

T- Test Results (1 Year Prior to 1 Year Post)

t-Test: Paired Two Sample for Means		
	W/ Activist	W/O Activist
Mean	8.799333333	16.18666667
Variance	44.339	59.407275
Observations	9	9
Pearson Correlation	0.550540988	
Hypothesized Mean Difference	0	
df	8	
t Stat	-3.227215546	
P(T<=t) two-tail	0.012107434	
t Critical two-tail	2.306004135	

FINAL COMMENTS

- It is clear that there are some major positive impacts to certain stocks from activists (Cracker Barrel and McDonald’s)
- More failures than successes when compared to the Menu ETF
- Paired T-Test showed that activist held companies stocks outperformed non-activist stocks from 10 days pre-announcement to 10 days post-announcement
- Paired T-Test showed that activist held companies underperformed those stocks of non-activist controlled companies from 1 year pre-announcement to 1 year post-announcement
- Overall it cannot be conclusively validated what the effect of these activists is on stock returns in this industry

FURTHER RESEARCH

- Use framework for research for other industries and business sectors to get a better idea on what the overall market effect of activist investors is (i.e. Retail)
- Measure the differences in capital allocation in these restaurants once an activist investor gets involved

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ACKNOWLEDGEMENTS:

I’d like to acknowledge Dr. West and Professor Barker for their role in helping me with my research efforts. I would not have been able to do this project without both of their guidance and commitment. Dr. Bailey and the many individuals who took the time to speak with me on the subject also played an integral role to my final project.

